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Abstract

Financial literacy provides knowledge and understanding of financial concepts and the skills, motivation and confidence to apply such knowledge and understanding in order to make effective decisions across a range of financial context and to improve the financial well of SMEs. Research shows that 65.1% of the SMEs in Kenya fail within their first year of operation. This study determined the relationship between financial risk management and the performance of micro and small enterprises in Moiben constituency, Uasin Gishu County, Kenya. The study adopted a cross-sectional survey research design. A total of 1923 registered micro and small enterprises in Moiben Constituency comprised the study population. A sample of 331 micro and small enterprises was involved in the study. Two stage sampling technique; purposive sampling and simple random sampling was used to select micro and small enterprises to be used in the study. A pilot study was conducted so as to test the validity and reliability of the research questionnaire. Validity of the research instrument was achieved by using of content validity test while reliability was tested using Cronbach's alpha coefficient. Self-administered questionnaires and a secondary data sheet were used to collect data. Data was analyzed using descriptive and inferential statistics and presented by use of tables, charts and graphs. The result of the study indicates that financial risk management affects the firm's performance of micro and small enterprises in Moiben Constituency. Performance of small and micro enterprises was found to be significantly affected by financial risk management ($t = 8.327$; $p = 0.041$). The study therefore recommends that stakeholders involved should therefore focus on developing programs to educate SMEs on how to assess, monitor and reduce risk of a given business portfolio. The study findings informs all the stakeholders in charge of the SMEs sector as it proves that financial literacy affects the financial performance of the micro and small enterprises.

INTRODUCTION

Financial literacy is the ability to read, analyze, manage and communicate about the personal financial conditions that affect the well - being (Huston, 2010). It guides a business owner to manage cash flow efficiently by identifying the most important expenditures those that bring about immediate improvements in productivity. It is vital for the business in estimating start-up costs that the business was incur before it starts operating and generating revenue. Financial literacy also enables managers and individuals to make a comparison on the various financial products and make the right financial decisions, thus avoiding fraudulent activities as they clearly understand their impact (Rooij, Lusardi & Alessie, 2011).

Governments around the world have expressed concerns about the low level of financial literacy amongst their citizens. The growing concern exists regarding the level of preparedness of the general population to make sound financial decisions. This concern is motivated by research that has demonstrated that many families lack basic financial literacy (Laura, Ernesto & Gema, 2015). Financial literacy rates differ enormously between the major advanced and emerging economies. In the world all over, financial literacy has been given a lot of attention and is believed to be a key ingredient to personal finance success and entrepreneurship; it's relevant to anyone who makes decision about money (Njoroge, 2013). Financial illiteracy puts a burden on the nation in the form of higher cost of financial security and lesser prosperity. For example, most people resort to investing more in physical assets and short-term instruments, which conflicts with the greater need for long-term investments, both for households to meet their life stage goals and for meeting the country's capital requirements for infrastructure. The potential magnitude of the consequences of a lack of financial literacy has been demonstrated by the financial crisis experienced in 2008 (World economic outlook 2010). Such lack of financial literacy has played a major role in contributing to the crisis.

Financial risk management is the practice of economic value in a firm by using financial instruments to manage exposure to risk. Risk management is a process of thinking systematically about all possible risks and problems before they happen and setting up procedures that was avoid the risk, or minimize its impact or cope with its impact (Kimari, 2013). Financial risks are risks faced by the business in terms of handling its finances for example defaulting on loans, debt load, or delivery of goods. Financial risks can be categorized into; market risks which are risks that arise because of possible losses due to changes in future market prices or ratios. The price changes was often relate to interest or foreign exchange rate movement, but also include the price of basic commodities that are vital to the business. Credit risk is type of risks that happens due to default by a counter-party. It typically arises when lenders lend money to borrowers and the borrowers fail to repay the loan. Customers who acquires goods on credit and fail to pay also poses a credit risks to the business (Ogilo, 2012). Liquidity risks refers to the uncertainty regarding the ability of a firm to unwind a position at little or no costs and also relates availability of sufficient funds to meet financial commitments when they fall due.

Micro and small enterprise performance refers to the observable ability of a business to meet or exceed projected goals or targets set by its shareholders within a specified period of time (Cherugong, 2015). Performance is used as an index of a firm's health over a dedicated period. This makes performance as one of the key issues of SMEs. In this study financial performance was be measured using a myriad of performance indicators in business practice; profitability, liquidity position, solvency, repayment capacity and enterprise financial efficiency was be selected as sufficient descriptors of performance (Benninga, 2014: Michalski, 2014). Access to finances is a key determinant of financial performance. Accessing bank loans easily improves the financial status of SMEs that subsequently leads to reduction on the cost of finance which includes higher interest rates, application fees, loan insurance premium, and legal fees. This in turn makes it easy for SMES to grow as accessing finance became easier and less costly (Kinyua, 2014).

Statement of the Problem

In Kenya Small and medium scale enterprises are engines of economic growth. They create employment opportunities, contribute largely to gross domestic product, aid in industrial development and satisfy the local demand for services (Cherugong, 2015). However, in Kenya 2.2 million micro and small enterprises shut down in the last five years from 2012- 2016 (Kenya National Bureau of Statistics KNBS, 2016). The high failure rate of new SME paints a bleak picture of SME sector' s potential to contribute meaningfully to economic growth and poverty reduction (Olawale, 2014). This has also led to loss of the business and personal assets. Despite the effectiveness of the management, if the financial decisions are wrong, profitability of the company will decline. Consequently, SME profitability could be damaged because of inefficient financial management leading to the failure of the enterprise. Failure of SMEs might stop the technological progress of national economy and depreciate country's competitiveness rate and make it less attractive to foreign investors. The collapse of SMEs also constrains production and export rate, making the whole economy to go slow (Kachembere, 2011). Despite the significant role played by the sector, research has shown that it has continued to experience many binding constraints that prevent the realization of its full potential (Wanjohi, 2012).

Majority of micro and small enterprises in informal sector, for example Jua Kali and farming managers do not manage their financial risk and yet they run very successful SMEs. More research is needed to find out whether the managers who do not manage their financial risk would be better if they had financial risk management skills (Njoroge 2013). This study therefore aimed to address the issue of whether financial literacy levels of SMEs influence the financial performance of the enterprise.

Objective of the Study

This study was be guided by the following objective;

i. To determine the effect of financial risk management on the performance of SMEs in Moiben Constituency, Uasin Gishu county, Kenya.

Hypothesis of the Study

H_{o1} The relationship between financial risk management and SMEs performance in Moiben Constituency, Uasin Gishu county, Kenya is not statistically significant.

THEORETICAL REVIEW

This section discusses the theory that forms the basis for the conceptualized relationship between financial risk management and performance of SMEs. The theory is modern portfolio theory.

The Modern Portfolio Theory (MPT)

Modern portfolio theory was developed by Harry Markowitz in 1952. The MPT is a theory of investment which attempts to maximize portfolio expected return for a given amount of portfolio risk, or equivalently minimize risk for a given level of expected return, by carefully choosing the proportions of various assets. The theory emphasis asset diversification to hedge against market risk as well as risk that is unique to a specific enterprise. Generally, assets with higher expected returns are more risky (Taleb, 2007). The risk in a portfolio of diverse individual stocks was be less than the risk inherent in holding any one of the individual stocks (provided the risks of the various stocks are not directly related). A portfolio that contains both assets was always pay off, regardless of whether it rains or shines. Adding one risky asset to another can reduce the overall risk of an all-weather portfolio. There are several assumptions of this theory. First all investors aim to maximize economic utility. Secondly all investors are rational and risk averse. Thirdly all investors have access to the same information. Fourthly they are no taxes or transaction costs. (Nielsen & Jorgensen, 2008). Lastly all investors are price takers.

This theory has been highly criticized, the first being that the theory does not really model the market. Secondly, modern portfolio theory does not consider personal, environmental, strategic, or social dimensions of investment decisions. Thirdly, modern portfolio theory does not take cognizance of its own effect on asset prices (Omisore, Yusuf & Nwufo, 2012). The modern portfolio theory is important to this study since it explains how SMEs managers can choose a set of assets to invest in for optimization of portfolio risk and return. According to this theory, enterprises can choose a combination of assets whose returns are negatively correlated hence decreasing the overall portfolio risk considering the uncertain external environment in Kenya.

EMPIRICAL REVIEW

Kinyua, Ogollah and Mburu (2015) carried out a study on the effect of risk management strategies on project performance of small and medium information communication technology enterprises in Nairobi. They used a population 48 ICT SMEs. The study established that there is a positive relationship between risk management strategies affecting project performance of ICT SMEs in Kenya and were statistically significant at 5% confidence level. The study further concluded that many ICT enterprises in Nairobi, Kenya have realized the importance of risk management practice in ICT project management in order to achieve process success. These enterprises carry out risk management to maximize their performance. ICT enterprises that manage risk effectively enjoy financial savings and greater productivity, improved success rates of new projects and better decision making.This study however failed to develop strategies that should be adopted to maintain the positive effects of risk management strategies on the project performance of small and medium information communication technology.

Genrikh (2015) studied the impact of enterprise risk management on firm performance of micro and small enterprises using the data obtained from FAME database that provides financial information on firms based in UK and Northern Ireland. Against the findings of most authors this study found no results that could support that enterprise risk management has any impact on the performance of the respective enterprises used in the study. The findings also do not

support the idea that men manage a company in more aggressive way while exposing it to higher volatility and performance during the first stages of growth. The study suggested that gender does not matter in assessing the performance of SMEs. This study did not take into account additional possible measures such as management qualification, average age of board, and international experience of CEO, possibly to be able to draw a concrete conclusion then the ones outlined in this paper.

Njoki (2014) carried out a study on financial risk management practices influencing business resilience in micro and small enterprises in Kenya using a sample of matatu saccos in Nairobi County. The study found that 62% of the respondents agreed that it took long while to restore the business to normal operations in case of disruption. In terms of diversification practices, 80% of the respondents disagreed that SACCOs had diversified their business adequately as a risk management measure. There was no statistically significant correlation between business resilience and diversification. The study concluded that matatu SACCOs only adopted automobile liability insurance as a risk management strategy which had positive influence on the resilience of their business. The matatu SACCOs did not practice any diversification strategies as a risk management measure of their businesses. This potentially affected their ability to recover quickly from events that disrupts the business. However the statistical estimates in the study was unreliable since it was based on a small sample of matatu Sacco while considered representative. However this study was based on a small sample of matatu Sacco while considered representative, another study using a larger sample could increase the reliability of statistical estimates.

Kalio and Ombogi (2013) carried out a study on the effect of financial risks on the performance of micro and small enterprises in the hotel industry in Nakuru municipality, Kenya. The study findings revealed that businesses in the hotel industry were yet to employ increased credit sales and still experience bad debts. The percentage profits by hotels increased steadily over the period 2009-2011. However the capacity of existing hotels in the study area had not increased to meet the increasing demand for hospitality services. Financial risk was found to negatively and significantly influence the performance of small and medium hotels. The risk with a high effect include credit and cash flow risks which were found to negatively and significantly influence revenues from food and accommodation. The study concluded that finance risks have a significant effect on revenue and profitability of small and medium hotels in Nakuru municipality. Although this study put into consideration some of the credit risks that SMEs face and their effect of their performance, it is evident that the survey was done to bring out the general situation of SMEs in the countries under study. This information, though important, did not answer the questions raised in the present study about the effect of financial risks in SME hotels.

Conceptual Framework

The conceptual framework gives the relationship between independent and dependent variables of the study (Luvavo, 2013). The independent variable identified was financial risk management while performance of SMEs in Moiben constituency was the dependent variable. It was be hypothesized that independent variable influence the dependent variable.

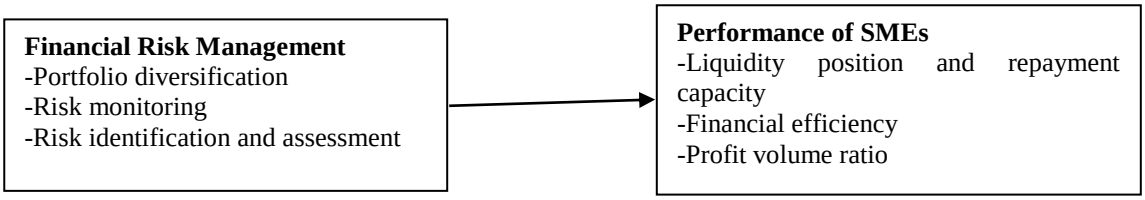

Figure 1.1 Conceptual Framework

The modern portfolio theory of investment attempts to maximize portfolio expected return for a given amount of portfolio risk by carefully choosing the proportions of various assets. MPT encourages SMEs to diversify assets to hedge against market risk as well as risk that is unique to the enterprise. It was established that a mixture of assets with low correlations with each other produces higher aggregate return for a given level of risk than a portfolio whose returns are highly correlated. The

possibility of this can be seen intuitively because different types of assets often change in value in opposite ways. It was also noted that assets in an investment portfolio should not be selected individually, each on their own merits. Rather, it is important to consider how each asset changes in price relative to hoe every other asset in the portfolio changes in price.

Research Gaps

Several studies have been conducted regarding financial risk management and SMEs performance. Susmitha (2014) conducted a study on growth and performance of small scale industries in India. The study did not assess the financial risk management practices. Cherugong (2015) carried out a study on the effect of financial literacy on performance of small and medium enterprises in Trans Nzoia County. However this study was limited to budgeting skills and record keeping as the variables and did not study micro enterprises. The reviewed studies above did not address specific issue focused in this study, the financial risk management. Therefore, this researcher main purpose is to fill this significant gap by providing systematic analysis of the effect of financial risk management on the performance of SMEs particularly in Moiben constituency Uasin Gishu County. To achieve this goal, the researcher analyzed the financial statements and the ability of the enterprise to meet its financial obligations of the representative SMEs.

RESEARCH METHODOLOGY

Research Design

Research design refers to the logical structure of the inquiry. It articulates which data is required from whom, and how it is going to answer the research question (Muaz, 2013). This research adopted cross-sectional survey research. The design was chosen so as to achieve the study objective of assessing the financial literacy of SMEs and its influence on the performance of the enterprise. SMEs can be categorized into several distinct sub groups based on type number of employees and the size of the enterprise. Given these circumstances, a cross-sectional study design was the most appropriate.

Study Population

Population is a large collection of individuals or objects that is the main focus of a scientific query. The target population refers to the entire group of individuals or objects to which researchers are interested in generalizing the conclusion. The target population in the study were all the SMEs in Kenya. Accessible population is the population in research to which the researcher can apply their conclusions. All 1923 micro and small enterprises, registered by County Government of Uasin Gishu Revenue Directorate as at 15th January 2018, comprised the accessible population.

Sample Size and Sampling Technique

A two stage sampling technique was used. Purposive sampling was used to identify Moiben constituency among the 47 counties in Kenya. Simple random sampling technique was used to identify sample for the study. Yamane's (1967) formula was used to determine the sample size. For a 95% confidence level and e = 0.05, size of the sample was determined by the formula below.

$n = N/1+N(e^2)$…….....Equation 1

Where n is the sample size, N is the population size and e is the level of precision. Accordingly, the sample size is shown below.

$n=1923/1+1923(0.05^2) = 331$.....Equation 2

The sample size was 331 micro and small enterprises operating in Moiben Constituency Uasin Gishu County, Kenya. Managers and SMEs owners were selected through random sampling because it's unbiased.

Data Collection Technique

The primary data for this study was collected through questionnaires. Self-administered questionnaires and face to face interviews were used to obtain the data. The structured questionnaire was selected because it is simple to administer and relatively less expensive to analyze (Kothari, 2004). Secondary data was obtained from financial records of the micro and small enterprises regarding the performance of the respective enterprises for the last five years.

Pretesting of Research Instruments

A pilot study was conducted to test the validity and reliability of the research questionnaire. It enables testing of the feasibility, instruments and methods (Sreevidya & Sunitha, 2011).This involved 10% of the size of the sample population (Kothari, 2004). Therefore 33 respondents randomly drawn from SMEs in Moiben Constituency were selected for pilot study.

Data Processing and Analysis

After the collection of data, the data was edited, organized into categories and coded ready for

analysis. The analysis was done using descriptive statistics where mean, mode, standard deviation and variance was used. Inferential statistics included regression analysis and Pearson product moment correlation with the help of SPSS Version 20.0. The data was then presented in form of graphs, tables and charts.

The following regression model was used;

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon \quad \text{.....Equation 3}$$

From the equation above;

Y represents the performance of micro and small enterprises in Moiben constituency, β_0 represents the y-intercept, $X_1 \ldots X_4$ represents independent variables, $\beta_1 \ldots\ldots\ldots \beta_4$ represents the coefficients of the independent variables and ε_i is the error term.

RESEARCH FINDINGS AND DISCUSSIONS

Descriptive Analysis of Effect of Financial Risk Management on Financial Performance of SMEs

The study sought to examine the effects of financial risk management on financial performance of SMEs. The results of the analysis are as shown in Table 2.

Table 2: Descriptive analysis of Financial Risk Management on Financial Performance

Financial Risk Management		N	Min	Max	Mean	Std. Deviation	Variance
i)	We diversify our portfolio to reduce risk	265	1.00	5.00	4.0642	.92095	0.85
ii)	Funds are used to purchase assets with highest expected return for a given level of risk	265	1.00	5.00	3.7094	1.02733	1.06
iii)	Risk and return are closely monitored	265	1.00	5.00	3.6151	1.12267	1.26
iv)	The enterprise has the ability to identify and assess risk	265	1.00	5.00	2.5962	1.21823	1.49

The respondents agreed that there is a clearly defined plan for reallocation of funds in the investments of the business (mean = 4.0642; std dev = 0.92095; var = 0.85). They also agreed that the micro and small enterprises used the funds to invest on projects with the highest returns (mean = 3.7094; std dev = 1.027; var = 1.06). In addition the managers/owners agreed that they monitored there risk closely (mean = 3.6151; std dev = 1.12; var = 1.26). The study further noted that the respondents were not equipped with skills on how to identify and assess risk (mean = 2.5962; std dev = 1.21823; var = 1.49). The study findings mirrored the views of Kinyua, Ogollah and Mburu (2015) on the effect of risk management strategies on project performance of small and medium information communication technology enterprises in Nairobi. The study found that there is a positive relationship between financial risk management and financial performance of SMEs. The study concluded that SMEs need to manage risks effectively for better production and increased financial growth.

Inferential Analysis

The relationship between financial risk management and financial performance of SMEs was determined. Table 4 shows the results.

Table 3 Correlation Analysis for Financial Risk Management

		Financial performance
Financial Risk Management	Pearson Correlation	.218**

	Sig. (2 tailed)	.000

**. Correlation is significant at the 0.01 level (2 tailed).

The study found that the relationship between financial risk management and financial performance was positive and significant ($r = .218$; $p < 0.01$). This implies that the more the micro and small enterprise manages its financial risk the more the financial performance improves and vice versa.

Multiple Regression Analysis

Multiple regression analysis is a powerful technique used for predicting the unknown value of a variable from the known value of two or more variables- also called the predictors. In this case, multiple regression analysis will help predict financial performance from financial risk management. The results from multiple regression analysis are as shown in Table 5.

Table 4: Multiple Regression Model Summary

R	R Square	Adjusted R Square	Std. Error of the Estimate
.690[a]	.476	.470	1.40152

a. Predictor: (Constant) financial risk management
b. Dependent Variable: financial performance

Table 5 shows the relationship between Financial risk management indicators and financial performance of SMEs was positive ($R^2 = 0.476$). This indicates that 47.6% of the variation in financial management is accounted for by financial risk management scores.

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Coefficient Analysis

The study also conducted coefficient analysis from multiple regression analysis. The results of the analysis are shown in Table 6

Table 6: Coefficient analysis

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.418	.700		.596	.551
Financial risk management	.248	.030	.409	8.327	.041

a. Dependent Variable: Financial performance

Based on the results of coefficient analysis, the study found out that financial risk management significantly predicts financial performance ($t = 8.327$; $p < 0.05$). Thus the study rejected the null hypothesis that there is no significant relationship between financial risk management and financial performance of micro and small enterprises in Moiben constituency, Uasin Gishu County, Kenya at a significance level of 5%. The study therefore concluded that there is a significant relationship between financial risk management and financial performance of micro and small enterprises in Moiben constituency, Uasin Gishu County, Kenya.

From t-test results of individual regression coefficients, the independent variables are included in the regression equation as they were significant ($p < 0.05$). Equation 4 shows the results of multiple regression model.

$Y = 0.418 + 0.248X_4$……...……..…Equation 4

The argument of modern portfolio theory of risk and return optimization through diversifying investments is also seen in the results of the study.

SUMMARY OF FINDINGS

Effect of Financial Risk Management on Performance of SMEs

The study agreed that SMEs have diversified their investment as measure to mitigate risk. It was agreed that SMEs utilize their funds effectively by purchasing assets with the highest returns and with a shorter repayment period. The study further established that the respondents were not in agreement whether they had developed mechanisms to closely monitor risks and return. It was further established that it was not clear if the micro and small enterprises had the ability to identify and assess risk. The study noted there exist positive and significant correlation between financial risk management and financial performance of micro and small enterprises. The study established that if enterprises improved financial risk management there could be a significant increment on financial performance. These findings on the effect of financial risk management on financial performance are in

agreement with the modern portfolio theory that SMEs need to maximize expected return given a level of risk.

Financial Performance of Micro and Small Enterprises

The findings of the study shows that the respondents were in agreement that the net profit of micro and small enterprises has been improving for the past five years examined by the study. The total assets turnover though not consistent from one year to another has also been improving. It was also established that the respondents were in agreement that micro and small enterprises ability to generate income from investment in its total assets has been improving. The findings further established that SMEs ability to generate income from the investments in net assets has also been improving. Generally, the study found that financial risk management practices examined by the study significantly influenced financial performance.

Conclusion

The study concluded that there is a positive and significant relationship between financial risk management and financial performance of SMEs. The idea of micro and small enterprises diversifying their portfolio and investing in projects that have got a shorter repayment period facilitates faster growth of the firm. It also reduces risks associated with the investment. This is in line with modern portfolio theory that emphasizes for risk minimization for a given level of return and maximizing portfolio expected return.

Recommendations

Based on the findings the study recommends that SMEs owners/managers should incorporate financial risk management into the firm. They should be able to monitor and manage financial risk and develop mitigation measures to curb the identified risks.

The study also recommends measures with regard to practical applications of the theory that support the study. This study recommends that the principles of modern portfolio theory be applied in choosing investments to be undertaken by the SMEs. This will ensure maximization of portfolio expected return and hence improving its financial performance.

The study recommends that the department in charge of small and micro enterprises in Uasin Gishu County should come up with financial risk management strategies to aid in better management of the risks involved in the whole financial planning process and its implementation hence better financial performance.

Recommendation for Further Research

The study used a sample population from Moiben Constituency in Uasin Gishu County. This study therefore recommends a further research should be conducted to evaluate the effects of financial risk management on performance of all small and micro enterprises in Eldoret town. The assumption here is that Eldoret town has many small and micro enterprises than Moiben Constituency. This will lead to an increase the number of the respondents and hence the sample size to be used in the study.

From the findings of this study financial risk management aspects explained less than fifty percent change in financial performance. This implies that there are many other factors that account for the remaining change in financial performance. This study recommends a further research to be conducted to evaluate the effects of other aspects on financial performance of micro and small enterprises in Eldoret town.

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